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ABSTRACT

The purpose of this paper is to outline some policy options that might be considered by decision-makers in Illinois as they struggle with school finance in adequately funding the public schools, but also bringing about property tax relief. First the report looks at ways of attaining property tax relief through the distributive side by discussing state dollars to aid local school districts offset inflation, for equity purposes, and for property tax replacement. Then the report describes ways of attaining property tax relief through the options on the revenue side. Options discussed include freezing property tax levies, property tax reductions, property tax assessment, and property taxes not allowed to exceed a standard percentage of an individual's income. A general strategy is outlined for attaining property tax relief without at the same time reducing the level of educational services in the school districts. (Author/MLF)

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ILLINOIS SCHOOL FINANCE IN AN ERA OF PROPERTY TAX RELIEF: SOME ALTERNATIVES TO A PROPOSITION THIRTEEN

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"If the state assumes a centralization stance because it is providing most or all of the money, the local school board member may become an endangered species like the snail darter."

-Professor Michael W. Kirst, President
California State Board of Education

I. Introduction

The location of the motion picture industry in California seems particularly appropriate these days. Certainly it can be said that the State of California has a unique ability to "dramatize" an issue. Perhaps this began with the gold rush, but it continues to the present day. In recent years, California has dramatized several issues in K-12 finance. For example, concern for equalizing educational opportunity existed in K-12 finance circles long, long before Serrano v. Priest, but that California case did serve to launch a wave of legislative changes in a great many states which, at least partially, were to the benefit of students in the less affluent school districts.(1) Now we have "Proposition 13" from California and another old concern of school finance, local property tax relief, is being "dramatized." This new tidal wave of state legislative activity is, however, occurring on the revenue side of school finance, rather than on the distributive side of school finance. That fact may give the school finance community a bit more difficulty than did Serrano. School finance professionals are usually more comfortable dealing with grant-in-adjustments than they are dealing with tax reforms. They are also more knowledgeable about grants-in-aid than they are about tax reforms. The new wave of legislative activity is, nevertheless, taking the form of either statutory or constitutional limitations on taxing and spending by all state and local governmental units, including school districts.(2) The policy question

now being addressed is not the traditional equity question of, "Who gets the money?"; it is rather the question, "How much should be spent?", or more correctly, "How much will local districts be allowed to spend?" As both Tron and Wilken have pointed out, that is not a new policy question.(3) State legislatures have imposed taxing and spending limitations on local districts for quite some time. Tax relief questions have, however, been raised to new heights of visability by recent political actions in California.

There is an immediate and major public policy problem that we have addressed in a previous publication for the Illinois Association of School Boards.(4) That is, can the new tax reform movement be reconciled with the older equal educational opportunity movement? Essentially, our conclusion to date is that the answer is yes, if one is looking only at the local side of the revenue picture. Tax caps, or spending increase limitations, are not only reconcilable with equalizing educational opportunity, they have indeed formed an important part of the strategy of states like Florida, New Mexico, and Minnesota in bringing about less expenditure disparity between school districts. Basically, the strategy in these states has been to raise the foundation level, while simultaneously shutting off the revenues raised on the local side through very restrictive tax caps. However, the advocates of spending limitations usually propose limiting not only the local side of the revenue picture, but also limiting the state spending for education as well. Very restrictive spending or taxing limitations on the state spending side are simply not compatible with equal educational opportunity reforms and the Serrano type decisions of many state courts. Almost all reforms addressing the Serrano problem call for an increase in state funding of education. Under very restrictive state tax caps or spending limitations, it would not be possible to raise enough state

dollars to offset the interdistrict differences in local district wealth, which are still the primary reason for interdistrict differences in expenditures per pupil.

The purpose of this paper, however, is not to expand the discussion of whether "Proposition 13" did, or did not, bring California into compliance with Serrano, or whether similar proposals in other states can also bring attainment of wealth neutrality goals sought in Serrano type suits. Our purpose here is to outline some policy options which might be considered by decision-makers in Illinois as they struggle with school finance in this new era in which we must consider not only adequately funding the public schools, but also bringing about property tax relief. We shall attack the problem of attaining property tax relief in two stages. First, we shall look at ways of attaining property tax relief through the distributive side of the school finance picture, and then we shall describe ways of attaining property tax relief through the options on the revenue side. As usual, the matter is complicated because we are seeking ways to provide property tax relief, and still provide adequate funding for the public schools. Many proposals are being put forward currently in Illinois which would provide property tax relief, but they would also result in drastic reductions of local educational services. We will obviously try to avoid solutions to property tax relief that would also wreck public education.

II. Distributive Options

Let us assume for the sake of the argument that local tax burden is primarily a matter of the effects of inflationary costs. It then follows that one method of relieving local tax burden is for the state government to assume some, or all, of the costs of inflation. We will also have to assume that neither statutory nor constitutional spending limitations have been passed in

Illinois which would prevent the state government from taking this responsibility. We then have several legislative options to consider. If the state picks up all of the costs of inflation in both the rich and poor districts alike, one way to do this is by a simple flat grant. This flat grant could be the product of an "allowable growth factor" determined by the legislature based upon their estimate of either the inflation that was expected in the next school year, or the expected growth in state revenues, or both, times some base expenditure level. For example, this might be 7 percent times a foundation level of $1,400. It might also, however, be 7 percent times the average expenditure in the state. One advantage of this particular option is that it provides a way to defend a flat grant. Flat grants do not generally fair very well when they are subjected to judicial scrutiny in Serrano type cases. However, from the practical political point of view, flat grants are often necessary to obtain the votes of the legislators from the more affluent districts when one is attempting to pass an omnibus legislative proposal.

The objection to flat grants for inflationary purposes is that this will move the state away from equity goals, e.g., the rich receive these grants, as well as the poor. Another option would be to release the assumption that the state government is going to pick up all the costs of inflation, which may be hard to sell to the legislature anyway, and place a part of the inflationary burden back on the shoulders of the local district. This can be done by scaling the categorical inflation grant so that poor districts receive larger inflation grants than do rich districts. In which case, the categorical inflation grant might look something like the following:

$$G = \left[1 - \frac{V_i}{V_h}\right] \cdot \left[.07\ (1400)\right]$$

where:

V_i = property valuation/TWADA in the district

V_h = either the property valuation in the wealthiest district in the state, or, more likely, the valuation per pupil in the district at the 90th or 95th centile.

This second option, scaling the categorical inflation grant, would be less expensive to the state government. In essence, one is asking here that the state pick up most of the inflation costs in the poor districts and that the richer districts share that burden with the state. This again assumes that neither statutory nor constitutional limitations of the type described in the second part of this paper have been passed in Illinois which would prevent the district, no matter how wealthy, from picking up the inflationary costs.

An objection to both the above options is that dollars will be diverted from the major grant-in-aid formula into this categorical grant for inflationary purposes. The objection is certainly valid if the state government picks up the whole cost of inflation, since that would absorb most of the available state dollars and very little would be left to go into the major grant-in-aid formula. This gives rise to a third policy option for dealing with inflation, that is, escalating the foundation level by an "allowable growth factor" determined each year by the legislature. This option has the advantage of solving some other problems. If the foundation level is not systematically raised each year, then more and more districts will find that they are "bounced out" of the foundation coverage. This comes about through the joint effects of inflation on property valuations and through the loss of pupils. As pupils are lost and property valuations go up through inflation, the property valuation per pupil rises at an accelerated rate. This phenomena not only causes a number of moderately wealthy districts, often farm districts, to be bounced out of the coverage of the foundation formula. It also causes less state funds to be spent

and more local funds to be needed. Some authorities discuss this phenomena under the term "slippage" in the grant-in-aid formula. What they mean by that term is that unless the parameters in the formula are constantly adjusted upward, the effects of inflation and the loss of pupils will call for fewer state dollars with the passage of time, and the balance of state versus local dollars in the funding system will shift back toward the local side. In that event, equity problems will increase rather than get better. Thus, whatever equity element is in any formula will weaken automatically with the passage of time unless the parameters are systematically increased. The third option takes care of this by adjusting upward the foundation level to meet the inflationary costs. This could also be accomplished by adjusting upward the guaranteed valuation in the "resource equalizer" formula, if that formula is retained, a matter we will discuss below.

Regardless of which of these options is taken, or one not discussed, we do believe that the major thrust in the grant-in-aid reform in Illinois at this point in time should focus on the inflation factor. Inflation causes all grant-in-aid formulas, no matter what they are like, to become obsolete and, therefore, the legislature must face this task on a continual basis. However, and this is an important point, in our view the state has the obligation not only to help the local school districts with their inflating costs, but also to <u>control</u> those inflating costs as well. This control aspect will undoubtedly not be very popular among professional educators. If the state government merely picked up the costs of inflation, in part or totally, without also attempting to put a lid on those increasing costs, then the state government could be justly accused of adding to the inflation problems of the nation, rather than attempting to help solve those problems. Therefore, we believe that there will be a price attached to having the state government assume the costs of inflation, in part

or in whole. That price will be to accept the notion of expenditure growth controls imposed by the state government, or, if it sounds somewhat better, a notion of "controlled or allowable expenditure growth" over all local school districts. We will return to this notion later in this paper, but let it simply be pointed out here that the idea of "controlled expenditure growth," through state-imposed expenditure growth limitations, has been a part of the school finance scene in other states for many years. Wilken indicates that ten states had some form of expenditure growth controls as of 1976 and Tron places the number at eleven, including the neighboring states of Iowa, Wisconsin, and Indiana.(5)

If both tight tax caps and expenditure controls are combined, then Illinois is, in fact, in the minority in the Midwest in not having these kinds of cost curtailment practices.

Stressing the inflation factor and the opposite side of the coin, the cost curtailment factors, at this point in time on the distribution side does not mean that equity goals have been forgotten. Equity goals, however, may now be better served by a foundation level approach than by the "resource equalizer" approach adopted in 1973. There remains some doubt in the professional literature as to whether a district power equalization (DPE) approach, of the type passed in Illinois in 1973, can accomplish equity goals in the long run. We have written on this matter extensively elsewhere.(6) On the basis of the best evidence we have at this point in time, it would appear that there are short-run beneficial effects from DPE systems relative to equity goals, but that the long-run consequences are not so helpful to attaining equity goals. The question turns on the response of poor districts to the "reward for effort" held out by the state. It is not clear whether poor districts can take advantage

of this reward by upward movement in their tax rates.(7) In any event, public opinion, and some professional opinion, seems to be running against almost all kinds of local initiative grant-in-aid systems and any form of "reward for local district effort." This movement is greatly aided and abetted by court cases in a number of states, especially Ohio and Colorado, which are beginning to cast doubt on the constitutionality of "reward for effort" systems.(8) There can be little question that "reward for effort" systems are intended to raise local property tax rates, at least in the long run, and thus keep a goodly share of local money in the K-12 funding system. This is precisely what the new tax reform movement does not want. The goal of tax reform groups is often lower property tax rates and less local money in the overall funding system. Some tax reform groups, of course, simply want less money in the system, period--local and state.

Given this climate of opinion, it may, therefore, be useful for the Generaly Assembly to consider the abandonment of the "resource equalizer" adopted in 1973, or at least the partial abandonment of that system. In its place the General Assembly might install a new foundation system augmented this time by (a) an inflation factor and (b) by either a limited aid to high tax rate districts, or by an actual property tax replacement grant, which will be discussed below. As a first approximation, a foundation level of $1,400 and a tax rate of $3.00 for unit districts, $1.95 for high school districts, and $1.05 for elementary districts might be realistic. It would be necessary to make the $3.00, $1.95, and $1.05 purely "calculation parameters" in the formula and <u>not</u> required or mandated tax rates. This maneuver would avoid the necessity of having the legislature mandate an increase in some local tax rates, which, of course, would not be in keeping with the avowed intent of this whole approach to ease local property tax burdens.

We thus arrive at a three-part proposal for the distribution side in Illinois: an inflation factor, a foundation program, and an aid for high tax rate districts. A choice has to be made on the third factor. If it is deemed desirable to maintain some amount of "reward for effort," then this part of the allocation system can be set up so that it functions like a miniature resource equalizer. However, if it is no longer thought desired to stimulate higher local tax rates, then this factor can become property tax replacement. In this latter choice, no new monies are obtained for the schools in this particular section of the distribution system. New monies are obtained only in the inflation part of the system and, if the district is poor, in the equity part of the system. Again, in the present tenor of the times, it would seem that "property tax replacement" would be more politically acceptable than a mini-version of the present resource equalizer.

There are several options in the property tax replacement section. One could, for example, use a technique found in Missouri at the end of the 1960's. At that point in time, Missouri simply sent $14 per child to each district with a tax rate in excess of $3.50. If property tax replacement is the goal, this $14 per child would have to be used to lower the local tax rate toward the $3.50. The $14 and the $3.50 are purely arbitrary and other parameters could be chosen. This approach would, of course, give property tax relief to both the rich and the poor alike. It is similar in some respects to the notion of giving inflation assistance to the rich and the poor alike discussed earlier. It is also possible, however, to assist, in this third section, only those districts which are also property valuation poor. If the option is to assist only those districts which are characterized by high tax rates but are also property poor, then a formula for this third part which looks much like the present "resource equalizer" can be retained, but reconfigured to provide

funds only to those districts with high tax rates and poor property valuations:

$$G = r \left[V_a - V_i \right]$$

where:

r = the positive difference between the actual operating tax rate in the district and tax rates of .0300 (units), .0195 (elementary), and .0105 (high school), or perhaps .0195 for both elementary and high schools

V_a = the average valuation per pupil in the state for each category district (unit, elementary, and high school)

V_i = the local district valuation per pupil

The parameters are again purely arbitrary here. If this is a property tax replacement grant, there is no need for the tax rate values to necessarily be .0300, .0195, and .0105. They could be higher values. It can also be argued that there are districts in the state with property valuations somewhat above the state average valuation for their class of district that also need property tax relief. Many of these are suburban districts with large numbers of children to educate. These "dormitory" districts are beset with unusually high property tax burdens.(9) That being the case, a value for V_a above the state average might well be used. Of course, the higher V_a is set, the greater the cost to the state for this particular section of the distribution system. However, if the property tax replacement notion is used, it must be firmly kept in mind that the new state funds going into this third section are simply state dollars used to replace local dollars. The added cost to the state is not buying added educational services; it is buying property tax relief. New dollars for the schools are gained only in the inflation grant and, if the district is property valuation poor, in increases in the foundation level.

Before proceeding to the revenue side of the situation, let us acknowledge some problems with this proposed three-part distribution system. It can be argued that the three parts compete with one another. A dollar used

for the inflation offset is not a dollar that can then be used for equity purposes, or a dollar that can be used for property tax replacement. This is true, but then there are also parts of the present formula that compete with one another. The same can, in fact, be said of any multi-factor distribution system. We are also open to the charge that we have not provided a single formula. This is also true, but then a three-part formula is perhaps a small improvement over the four-part general distribution we currently have in Illinois, e.g., one part in the resource equalizer and three parts in the older Strayer-Haig portion of the law. It can even be admitted that the adoption of this three-part approach to allocation may move us back, temporarily we hope, from some equity goals in the state. This last point would only be clear after the exact options and parameters are known and we have run computer simulations with these options. However, as highly desirable as equity is as a state fiscal goal, it should not control all the actions of the legislature, at all times and in all places.

Most assuredly, this tri-partite proposal does not answer all the problems of distribution systems in Illinois. It is silent on a number of important problems such as: (a) access of unit versus dual districts to state general revenue, (b) possible use of an income factor, (c) possible use of a geographic cost of living factor, (d) exploration of new definitions of poverty impacted pupils and of weightings for compensatory education, (e) use of weightings for special education and vocational education in place of categorical programs, (f) incentive factors for reorganization and consolidation, etc., etc.(10) However, one cannot fight all the battles at one time. We have made a decision that inflation, equity, and property tax relief are where the attack should be launched for the moment. The war will continue against the many problems of allocation systems and these other battles can be fought another day.

III. Revenue Options

It may help the analysis on the revenue side to clarify first what is meant by "property tax relief," which is presumably the public policy goal desired by a majority of the electorate in the state. "Relief" can be brought about at least three different ways. One could be talking about "allowable" or "permissible" growth in property tax revenues for education, or in total spending for education. This would then be a kind of "relative" relief since some growth in property tax revenues would still be allowed, but revenue growth would be smaller than in the years prior to the adoption of local revenue control measures by the state legislature. One could also, however, be talking about freezing property tax revenues for education where they are at one point in time, e.g., the property tax burden remains the same as in previous years. Finally, one could be talking about actually reducing the amount of property taxes paid by either every property taxpayer, or only certain sub-populations of property taxpayers. Obviously, the third form of "tax relief" is the most distinctive; it shows up on the property tax bill of some or all taxpayers and is also the most politically popular. We shall order the discussion of legislative options around these three notions: controlled property tax growth, property tax freeze, and property tax reductions.

Looking first at the notion of controlled property tax growth, there are some general arguments for and against this notion that should be outlined before one deals with specifics. The case against state control of local expenditure growth starts with the argument that local boards are better agents for determining the educational needs of their geographic area than is the state legislature. This was the justification for "local control" in the first place and meaningful "local control," it is argued, includes determining the level at which education will be supported by the taxpayers. That this traditional

"local control" argument is still foremost in the minds of many local superintendents can be seen in the results of a recent attitude poll conducted in Iowa, which stressed the loss of flexibility at the local level under a system of state budgetary controls.(11) Iowa is a state with considerable experience in "controlled budgets" and if the General Assembly in Illinois is seriously considering the notion of controlling local expenditure growth, then the Iowa experience should be closely reviewed.

Second, it is argued that the state legislature may set the allowable growth rate too low to offset the actual rate of inflation. This might be accidental, that is, the estimate of the inflation rate for the future fiscal year was just less than the actual inflation rate turned out to be. It could also be deliberate, e.g., the state legislature might feel that there is some "slack" in local budgets and that deliberately setting the allowable growth rate below the inflation rate will force many local districts to economize and adopt better business management practices. Since the growth factor is set each year, however, mistakes of a prior year could be corrected in the following year.

Third, there is an adverse effect of controlled property revenue growth upon the property wealthy districts. In almost all states, property wealthy districts must depend upon what revenues they can raise locally rather than upon state aid. If local property revenues are not allowed to grow as fast as general state aid, then the stage has been set for a "leveling up" or a "catch up" process by which low spending districts are being brought up and high spending districts are being held back. In some states (Colorado, California pre-Proposition 13, and Iowa), this was a deliberate state policy, e.g., low spending school districts were allowed to increase their spending levels faster than high spending districts. This is sometimes referred to in the literature as a "squeeze" approach to compliance with Serrano.

The fourth and fifth arguments against a "controlled property tax growth" policy relate to a "leverage" effect that is believed to be present in educational finance. Educational demand is thought to be affected by a "demonstration" process.(12) That is, educational facilities and programs demonstrated to be effective in one school district are frequently adopted by surrounding school districts. At least in the past, when admittedly the economic climate for public education was much more supportive than at the present, local school boards actively sought out these "innovative" programs in other school districts and implemented them in their own districts. So-called "lighthouse" districts, frequently the more affluent districts, were encouraged to adopt innovative educational practices even if this meant higher educational expenditures, and it usually did mean increasing costs, in order to increase the overall effectiveness of public education. Whether these innovative programs were cost-effective, as well as just educationally effective, is an open question, but they probably did have the effect of increasing educational demand. Under controlled budget conditions one would expect to lose much of this effect. It would depend, of course, upon the actual parameters adopted in a controlled growth process, e.g., a limitation of 3 percent increase a year would have a much greater restrictive effect than a limitation of a 9 percent increase per year. A variation of this argument holds for teachers' salaries. In the collective bargaining process, there is also believed to be a "demonstration" phenomena at work by which salary settlements in one district affect salary settlements in other districts. Teacher organizations have relied upon these leverage effects to increase their salaries. Both arguments four and five rest upon the assumption that "levering up" is an acceptable practice. Proponents of controlled local budgets would doubtless argue that perhaps this leverage effect has been too successful and the controls are intended to dampen down this phenomena. Fundamentally,

many advocates of state-imposed local school budget growth controls believe that too much is being spent on education and the rising costs of local districts need to be constrained, including any leverage process that might exist in the demand system.

The sixth and seventh arguments against local tax and/or expenditure controls are economically based. The sixth argument is closely related to the first argument, the local control matter. It is argued that the local districts can be regarded as "public households" in a market place, and that forces of supply and demand operate through this admittedly very imperfect market place.(13) There is no assurance that substituting the "superior" judgment of the state government for this market composed of local districts will improve economic decision-making. To the contrary, the risks of either oversupply or underdemand are probably increased when this quasi-market place is ignored. To be sure, this quasi-market of local school districts is a highly subsidized and tightly controlled market and does not approach the system of household markets that some analysts would recommend as the funding system for education.(14) Nevertheless, it is a market place of sorts where each district acts like a household and buys a certain amount of educational services. Substituting the political processes within the state legislature for this quasi-market does not assure one that the basic economic decisions will be made any better, and they may well be worse. Related to this last position is an interesting question of whether the controls on local government taxing and spending that we already have in various states do actually work to keep costs down. There is at least some empirical research which suggests that they do not work very well.(15) These studies suggest that increasing educational costs may have more to do with the lack of technical productivity gains in education and with increasing environmental problems in education than with more controllable items. The bottom line

here may be that if a state legislature imposes revenue controls but the local districts cannot control their costs due to factors largely outside their own local managerial span, then the inevitable result of revenue controls will be a reduction of educational services, whether the legislature actually had that in mind in imposing revenue controls or not.

These are formidable arguments against state-imposed local revenue controls. There is another side of the coin, however, as in almost all other matters of eudcational fiscal policy. First, it is difficult to see how we can advocate that the state government take over either part or all of the responsibility of meeting inflationary costs without also giving the power to the state government to help restrain that same inflation. If we advocated state assumption of inflationary costs and then allowed the districts to also continue to meet these inflating costs from the local property tax revenues, we would be double funding the inflation. In the present national context, this might be considered almost unpatriotic. It would certainly contribute to the inflation, rather than attempting to control the inflation. It should be clear, however, that if the legislature imposes local revenue growth limits on school districts, it is imposing what amounts to "mandatory" wage and price controls in the public sector when only "voluntary" wage and price controls have been requested, at least thus far, by the President in the private sector. It would not be the first time, however, that the public sector has been asked to do more in inflation control than the private sector.

Second, there are some benefits from operating under a controlled local budget situation that might escape first glance.(16) If the state limits yearly expenditure or property tax revenue growth, and it could be either of these two factors, to a fixed amount, then a great deal more local planning is possible further in advance in most school districts. At present, Illinois superintendents

complain, with some justification, that they must await the last day of the legislative session before they know how much state aid they will have for the next fiscal year. This is an exaggeration, but there is an element of truth in it since the parameters in the allocation formula have been changed a great deal in the last few years and prorations of the formula have further complicated local planning. If the annual growth factor could be determined fairly early each year in the legislative session, local superintendents would have a much better fix on resources available in their local school districts than they do now. Apparently, there is such lead time in Iowa. The local collective negotiation process is also greatly changed under conditions of state-controlled local budget growth. In many districts there is no real reason to negotiate the level of salary increase since the state government has already set that for all practical purposes when the general growth factor is determined by the state legislature. Collective negotiations then tend to focus on working conditions and other personnel matters, rather than on fundamental bread and butter issues. Collective negotiations seem to take on a much more orderly and low-key approach under these conditions of budgetary control. Much of the activity of the teachers' organizations under a local budget control situation shifts to the state level rather than continuing at the local level.

Third, the equity goals of school finance can be served by the expenditure control process. We have already mentioned that some states have deliberately allowed low spending districts to increase their spending more than high spending districts. There is another aspect of this equity matter. Some local superintendents in Iowa report that the growth factor actually becomes a "target" that local boards, who might not otherwise increase their expenditures that much, now try to reach. Since many of these districts who use the state growth factor as a "target" are low spending districts, the effect of the growth factor

is to move up low spending districts, thus reducing the disparity in educational spending between districts. One must assume, of course, that this additional spending also means higher service levels and a narrowing of the service level disparity as well.

Fourth, the local growth factor can also be used to offset inflation. This is the situation in Iowa since the growth factor is used not only to control local spending, but also to escalate the foundation level each year. The "growth factor" is therefore the attempt of the state to meet inflating costs and, at the same time, to control those costs. Fifth, the local growth factor encourages consolidation since large increases in cost necessary to keep very small school districts in business are no longer possible under controlled growth. With declining enrollments,more and more small schools can stay open only with very high costs per pupil. This last argument, however, depends upon the growth factor being stated in terms of expenditures per pupil, and there are problems with that formulation as noted below.

Finally, if it is thought desirable to soften local control of expenditure or revenue growth with elements of local control, this can be done with "voter overrides," a procedure by which voters at a referendum may go beyond the state expenditure growth limit. This is a common practice in a number of states, but it depends upon the growth limits being statutory rather than constitutional, unless the constitutional change also provides for the "voter override" procedure. It would not be unusual for the "override" to require something in excess of a simple majority vote. The "override" procedure is a way of gaining some of the benefits of state expenditure growth control, but also preserving elements of local control. An alternative way to go beyond state growth limits is to have them reviewed by an administrative board.

Once a policy decision has been made to limit local school district spending, a number of legislative options are then available. We have identified no less than eight questions which must be answered. First, it must be decided whether expenditure growth will be limited or whether it will rather be growth in property tax levies that will be limited. Generally speaking, most states have limited the expenditure growth of school districts. Property tax levy growth is constitutionally limited in Oregon and one of the three constitutional proposals being voted on in Michigan as this paper was being written would limit growth in assessed valuation of school districts and, hence, growth in property tax revenues, to the same rate of growth as the Consumer Price Index.(17) Second, growth limits can also be either statutory or constitutional. Most limits are presently statutory, but the Education Finance Center of the Education Commission of the States reports that no less than 13 states were awaiting constitutional action by their voters on spending and tax limitations on local governments, including school districts.(18) Third, growth limits can also be expressed as either a percentage or a flat dollar amount. Most states are currently expressing their limits as percentages, but the Iowa system imposes a flat dollar amount growth limit.(19) This particular legislative choice has equity implications. A flat dollar amount will encourage a reduction in variance in expenditures per pupil between school districts since the flat dollar amount constitutes a greater percentage of the low expenditure district base than the high expenditure district base. By the same token, high expenditure districts can be expected to lobby for a percentage growth limit rather than a flat dollar amount. Fourth, a decision must be made on whether the lower expenditure school districts will be deliberately allowed more liberal growth rates than the high expenditure districts. Colorado, Iowa, Kansas, New Jersey, and California, prior to Proposition 13, all allowed greater growth for low expenditure districts than for high expenditure districts. Fifth, a method will

have to be established to determine what the allowable growth rate will be. In Arizona, this is done by a special state commission. In Iowa, it is the combination of the Consumer Price Index and the estimated rate of growth of state revenues. Sixth, the growth rate itself will have to be established. On what limited evidence is available, there appears to be quite a variation between the various states on this rate. Illustrative allowable growth rates for school districts used in the past have included: 9.5% in Wisconsin, 8.8% in New Jersey, 9.4% in Iowa, 6.0% in Oregon, and 5.0% in Kansas. From this perspective, the annual growth rate proposed by the Illinois Tax Limitation Committee of 3% looks excessively restrictive.(20) Seventh, a decision must be made on whether the rate is to be applied to aggregate expenditures and aggregate revenue or whether the allowable growth rate is to be applied to expenditures per pupil or revenues per pupil. If a per-pupil specification is used, then an immediate problem presents itself. Expenditures could remain relatively constant from one year to the next in a school district, but, if the limitation is on a per pupil basis, much of the allowable leeway will be eaten away by loss of pupils--that is, the expenditure per pupil figure will rise not due to the increase in spending, but due to the loss of pupils. Finally, a decision must be made on whether some appeal from the growth limits will be allowed. This can take at least two forms. Some states allow an appeal to an administrative body which has the authority to grant increases in expenditures or revenue over the state allowable growth rate, and some states allow "voter overrides," e.g., referenda which will allow either a simple majority or an extraordinary majority to exceed the spending limits set by the state. At present, the growth limit proposal of the Illinois Tax Limitation Committee does not allow for any appeal from its 3% limit. This again appears to be unduly restrictive.

The second approach to "property tax relief" can be handled in much less space. Only two states, Indiana and Kentucky, have much experience with a freeze in property tax levies over any appreciable span of time. There are several difficulties with this approach. In the first place, it freezes in all the inequalities in both expenditures and tax burdens that exist at the point in time in which levies are frozen. The state, in essence, gives up all attempts to equalize the tax burden between school districts. Second, if the experience of these two states is any guide, the freeze cannot be kept in place very long. Both states have had to "thaw" their frozen levies in recent years. Kentucky makes an exception of new properties that come on the property tax rolls and Indiana makes exceptions for districts with growing pupil populations. Theoretically, the tax freeze could be a powerful way to achieve wealth neutrality and other equity goals. If wealthy districts could not raise their levies, and if state aid increased meanwhile to poor districts, the result would be greater equality of educational opportunity between the rich and the poor. However, if Indiana is any guide to what happens, the allocation system will be warped to help both the rich districts and the poor districts since the rich are cut off from their property tax base. The Indiana situation is complicated, but it is not by accident that at the present time 304 of Indiana's 305 districts do not draw aid from the equalization portion of the allocation system.(21) State aid is primarily distributed by a guaranteed minimum increase in state aid that goes to all districts, rich and poor alike. This type of aid was at least partially brought into existence because, with the levies frozen, some state funds had to be sent to the wealthy districts, as well as the poor districts, to keep them solvent in the face of inflating costs. Unfortunately, like many other simplistic approaches, the "freeze" is a good deal more popular with the rank and file voter than with those who are knowledgeable about public school finance.

The third form of property tax relief is property tax reductions. The important distinction here is that property tax reductions can occur in two ways: property tax reductions without replacement of dollars to the schools, and property tax reductions with replacement of dollars to the schools. If property taxes are reduced and the state does not replace those dollars to the schools, then service levels must be reduced. If the state does replace the dollars, then service levels can be maintained and property tax relief given to the taxpayers simultaneously. Property tax reductions with replacement of dollars is, however, not overall tax relief; it is rather a shifting of the costs of the schools from one tax instrument, the property tax, to two other tax instruments, the state sales tax and the state income tax. As we have pointed out elsewhere, general tax relief, at least of any appreciable size, can only be purchased by a reduction in the level of eudcational services.(22) Some very limited amount of general tax relief can be secured through economies found by local school boards and by strict adherence to good business management practices, but no one believes that tax relief purchased in this manner will be very great. Actually, the manner in which most states' grants-in-aid work causes the property tax reduction tactics to be grouped into three, rather than two, categories: reduction without replacement, reduction with partial replacement, and reduction with full replacement. We shall discuss each in turn below.

The prime example of reduction without replacement has to be Proposition 13, which was recently successful in California, and any other constitutional roll-back of property taxes which is currently being offered to the voters throughout the United States. It can, of course, be argued, and the Jarvis-Gann supporters would doubtless so argue, that even though no formal mechanism for the replacement of dollars existed in the Proposition 13 proposal, the "understanding"

was that a large part of the California state surplus would be used to replace property tax dollars for the schools and this has, in fact, happened. What happens when the state surplus is exhausted is anyone's guess. The broader effects of Proposition 13 in California have been discussed elsewhere and we could not do justice to the subject in the space available to us here.(23) We would note, however, that respected school finance authorities in that state, such as Charles Benson, James Guthrie, and Michael Kirst, are all agreed that the major effect of Proposition 13 was to shift California to an "almost" full state assumption position--that is, for all practical purposes, it is the state government that now makes the major decisions regarding the funding of K-12 education in California and not the local school boards. It is ironical to note that overnight the supporters of Mr. Jarvis and Mr. Gann accomplished what well-organized campaigns of full state assumption supporters could not accomplish in states like Michigan and Rhode Island. If the state legislature does not make further changes in the K-12 funding system, we will have a test case in California of whether full state assumption will work. Of course, it can be argued that we have already had "nearly" full state assumption for some time in Florida, New Mexico, and Minnesota, and that it will work. Whether local school board members will become as much of an endangered species as Chairman Kirst suggests in the quotation at the head of this paper remains to be seen, but there can be little doubt that the post-Proposition 13 role of school board members in California will be greatly different than their pre-Proposition 13 role.

There is also some degree of consensus among the experts that it is the more property wealthy school districts in California that are the most hard pressed after Proposition 13 and not the property valuation poorer districts. It is difficult to see how districts like Beverly Hills can long continue to

support their high levels of educational services unless the state adopts a local income tax or a local sales tax to support these services. The present attempts at private trust funds and transfer of some services to the private sector are clearly short term, or stop-gap, measures among the more affluent districts in California. The most important phenomena to watch after Proposition 13 is whether the upper middle class starts to withdraw their children from the public schools in districts like Beverly Hills and place them in private schools. The opponents of full state funding have always alleged that this will occur under FSA and we may now be able to test that argument empirically in California. The property valuation poorer districts in California will be less affected since they will still continue to receive more state funds, which are derived from the state income tax and the state sales tax. It is important to note that Proposition 13 in California did not cap off state spending; it was rather aimed at local spending. We shall return to this important policy matter at the conclusion of the paper.

Proposals for property tax reduction without replacement of dollars to the schools are springing up all over. There is, for example, a proposal being discussed in Illinois that would allow a 25% rollback in property tax rates via a petition of local voters. No matter what these schemes look like, they should be recognized for what they are. If no replacement monies are provided for the schools, then these are not just property tax relief proposals; they are also orders issued by the electorate to reduce the levels of educational services offered their children. If property tax relief were the only goal, then there are alternative ways to accomplish that, as outlined in this paper. If property tax reduction without replacement is adopted, we will have a clear signal from the people that their demand for public education is less than it was in prior years--a bitter pill indeed for many of us to swallow.

There is an intermediate category here that would provide property tax reduction with a partial replacement of dollars for the schools. These strategies are all characterized by a concentration on the property tax assessments rather than, as was the case in Proposition 13, a concentration upon the property tax rates. The partial replacement of dollars for the schools comes about because the grant-in-aid formulas of most states work in such a fashion that, as the property valuations of a district go down, all other things remaining equal, the district receives more state aid. This replacement is only partial because the dollars lost on the local revenue side are not totally replaced by state dollars. Generally speaking, it is the property valuation wealthy districts that lose more, since less of their valuation base is covered by the various state aid equalization formulas. Many of the tactics in this category are aimed at property tax relief for some specific sub-population of the electorate. For example, the recently passed farm valuation law in Illinois will provide property tax relief for school districts with high concentrations of farm valuations. An important study by Warfield shows that only some of this loss in revenue is replaced by state aid.(24) The same could be said of the issue of the removal of the remainder of personal property valuations from the tax rolls in Illinois, which was addressed recently in a study by Pierson.(25) Homestead exemptions for the elderly also have this effect, as does the removal from the assessment rolls of new industrial or commercial starts. The more important tactics here are aimed not at specific interest groups, however, but at the general population. For example, another of Michigan's three constitutional amendments would reduce the ratio of assessed valuation to true market valuation from 50% to 25%. We have also had a recommendation in Illinois to reduce the ratio from 33 1/3% to 25%, or some other ratio lower than 33 1/3%. This strategy would provide property tax relief and replace only some of those dollars with increased state aid.

The final category would bring about property tax reductions, but provide full replacement of those dollars to the schools. Without doubt, the most well known strategy in this category is the "circuit breaker." The general principle of the "circuit breaker" is that property taxes will not be allowed to exceed a stated percentage of an individual taxpayer's income. Michigan has a relatively long experience with a circuit breaker principle and, in the opinion of some authorities, it works rather well. The schools do not suffer a loss of revenues under circuit breaker approaches since the taxpayer goes ahead and pays his property taxes and then receives a credit on the state income tax, or an outright refund from the state. The recent "circuit breaker" proposals in Illinois were vetoed by the Governor on the grounds that the cost to the state was more than the state budget could absorb and that the techniques would not curb increases in school district spending. If the latter is the real reason for the veto, then the passage of expenditure control legislation of the type discussed earlier in this paper, simultaneously with circuit breaker legislation, will meet that objection. However, we suspect the real reason for the opposition to the circuit breaker is that it provides property tax reduction to only the middle income and low income taxpayer. If general property tax reduction to both the rich and poor alike is intended, then the circuit breaker does not accomplish that goal.

We have as yet been unable to uncover too many examples of property tax reduction with full replacement of those dollars for the schools, except the circuit breaker notion. The closest thing to this may be some forms of tax credits that exist in Iowa.(26) There the rural interests in the legislature succeeded several years ago in passage of property tax replacement legislation which provides state replacement dollars for taxes levied upon agricultural land, upon livestock, and upon personal property. These are, in essence, bookkeeping

entries with the local taxing authorities simply reducing the property taxes on agricultural land, upon livestock, and upon personal property by the amount the state has provided for these property tax replacement purposes. The schools still get the funds, but the rates on these three classifications of property are lower than they would be in the absence of state grants. At present, this constitutes about 10 percent of all funds in Iowa for K-12 education. Property tax replacement is a viable policy goal, but the difficult decisions are those concerning where the property tax replacements will take place. Are the replacement dollars intended to reduce the property taxes for all taxpayers, rich and poor alike? If the answer is yes, reduction is intended for rich and poor alike, then the state needs to create a special pool of funds for this specific purpose and distribute that pool back on some unit basis. If only the school governments are involved, it could be distributed on a per pupil basis. If other local governments are involved, then a per capita basis might be more appropriate. If only the schools are involved, is the reduction to occur in all school districts or only in those districts with high tax rates? Earlier in this paper we suggested a formula if the decision has been made to roll back taxes only in those districts with low property valuations and high tax rates. That, however, may not meet the widespread demand for property tax reduction. Obviously, if property tax replacement is accepted as a policy goal, more work needs to be done on techniques for accomplishing this goal. We will need, for example, to address the question of why property tax replacement should take place for the schools rather than the municipalities.

IV. Summary and General Strategy

This paper has assumed that property tax relief is a legitimate goal of school finance reform and has then outlined various ways to accomplish that objective in Illinois. It is, of course, the General Assembly, the Governor, the State Board of Education, and the State Superintendent of Education who

are the individuals charged by law with selecting the various fiscal options they wish to defend before the electorate. However, it would only be playing the game fairly if the authors indicate their own preferences. We will conclude, therefore, by outlining a general strategy for attaining property tax relief to taxpayers in Illinois school districts without at the same time reducing the level of educational services in those districts.

First, we would urge the various decision-makers to resist any scheme like California's Proposition 13 that does not provide for replacement of lost dollars to the schools, even though such a proposition does provide property tax reduction. As we have indicated, only if the electorate clearly wants a reduction in educational services should reduction without replacement schemes be accepted. Second, we would urge the rejection of the property tax freeze option since it does nothing but lock in all past mistakes. We urge the educational community, on the other hand, to lobby for the state absorbtion of some or all inflationary costs and for a relatively high foundation level formula. Concomitant with that, we would suggest the abolition of the "reward for effort" or "resource equalizer" method of distribution of state funds. The "resource equalizer" has served a useful purpose, but it cannot, in the long run, be reconciled with the desire for property tax relief. In return for the state absorbtion of inflationary costs, we would also urge the educational community to accept, painful as it may be, state controls of local expenditure or revenue growth. We would also urge the educational community to work for a notion of property tax reduction with replacement of dollars for the schools. If full replacement is not feasible, then the next best policy position is partial replacement, such as would come about if the ratio of assessed to true market value were dropped from 33 1/3 percent to 25 percent through a period of time of more than one year. Finally, we urge the educational community, while ac-

cepting perhaps reluctantly the capping off of revenues on the local side, to resist the capping off of revenues on the state side. If state revenue limits or lids must be adopted on the state side, they should be sufficiently high to allow the continued shifting of the support of the schools away from the property tax base and over to the sales and income tax base. Very strict lids on spending on the state side are not compatible with the moves the state has made toward equalizing educational opportunities and should be resisted by those who still believe that Serrano type goals are important. Indeed, if an overly restrictive limit is adopted on the state side, it should be challenged in the courts on equal protection grounds.

Critics of this general strategy, and there will be many, will allege that the state dollars are just not there, even without lids or growth caps, to do the job of meeting inflation costs, providing for equity, and also providing for meaningful property tax relief. This is partially true. But this depends on how much of a job one intends to do. If only a small amount of effort is intended, then probably the increase in state revenue through the normal growth in the income tax and sales tax, without a change in the present rate structure, will suffice. However, if a serious attack is contemplated on these three policy goals, then an increase in the individual and corporate rate in the state income tax must be contemplated. Perhaps this might be mixed with a slight increase in the state sales tax. Before the readers fall off their chairs in fits of uncontrolled laughter over the notion of increasing the rates on the income tax in the present political climate, they might reflect on the thought that no Governor of Illinois has ever gone to the electorate with a plan to actually lower the property taxes with the dollars raised by an increase in the rates in the income tax. Governors in many states have often alluded to the possibility that property taxes might be reduced by an income tax rate hike, but few have proposed that all, or almost all, of a given rate hike be legally

earmarked for property tax reductions. A future Governor of Illinois might well consider offering the electorate a choice of raising their income and sales taxes and lowering their property taxes. It might not be nearly as politically unpopular as it first sounds.

Critics will also charge that we are not providing overall tax relief by the strategy that we have outlined, but merely shifting the burden of the support of the schools from the property tax to the income and sales taxes. They will be perfectly correct. We also acknowledge a danger in this in that the support of the schools will move more closely with changes in the state's general economic health. A major recession in the state at a time when the state is depending on the income tax to support the schools will pose serious problems. However, the danger is far less than a much more drastic situation that would result from the adoption of a Proposition 13 in Illinois. Critics will also point out that we are probably shifting control away from the local school district by urging that less property tax dollars go into the support of the schools and more state dollars. That we will also admit to, but again point out that our proposals are mild indeed compared to the major transfer of power that will accompany a Proposition 13 or something like it.

In a recent publication distributed by the Illinois Association of School Boards, we said that in the public sector, as in the private sector, there is no "free lunch." We reiterate that stand and add our fervent hope that the electorate in Illinois will not be misled into accepting something like Proposition 13 in Illinois when other fiscal options are open to them <u>that will also result in property tax relief</u>. We are calling on the educational community to make some hard choices. We are asking educators to accept state control of revenue growth at the local level and to accept a reduction in local property tax revenues in return for state assumption of the costs of inflation, greater

equity in the grant-in-aid formula, and meaningful property tax relief. There may be no "free lunch," but neither does a California type diet have to be rammed down the throat of a reluctant public.

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